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AUDITOR OF PUBLIC ACCOUNTS

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AUDITOR'S ALERT

*The Auditor's Office, in the form of an Auditor's Alert, periodically offers guidance and recommendations regarding fiscal matters, accountability, and best practices.*

**Recommendations for Public and Nonprofit Boards**  
*Lessons learned from the Lexington Blue Grass Airport Investigation*

The Auditor of Public Accounts, as a result of a recent investigation, makes the following recommendations to assist public and nonprofit Boards in designing and implementing internal controls. These recommendations should assist Board members in providing appropriate financial oversight. The following is a brief summary of various financial policy areas that Board members should consider. After each control area is considered, a policy should be developed to address the specific business model of the organization.

1. To minimize and control the cost of travel, a travel expense policy should be developed that specifically defines the allowable costs related to lodging, meals, entertainment, personal mileage reimbursement, rental cars, and airfare. The travel expense policy should state the invoice requirements for the reimbursement of certain expenditures such as taxi fees, tips, parking, or tolls. The policy should provide examples of expenditures that are to be paid for by the employee, such as costs incurred by family members or the attendance at events not approved by the Board. This policy should explicitly state that expenses not in compliance with the travel expense policy would not be reimbursed or paid by the Board.
2. Executive management traveling out of state should present their plans and estimated costs to the Board for prior approval. The approval of these activities and associated costs should be addressed at the Board meetings to ensure proper documentation in the minutes. Subsequent to attending approved conferences or activities, the amount expended should be reported to the Board.
3. If the use of credit cards is needed, the Board should implement the following oversight controls:
  - A Board member should be assigned to review all credit card statements prior to payment.
  - Credit card charges should be supported by an expense report that provides detailed receipts and explanations. The employee should be responsible for the timely payment of any unsupported credit card charges or disallowed expenses.



- The Board should ensure that all review procedures are performed in a timely manner to avoid late fee and finance charges.
4. In lieu of credit cards, the Board should consider the following:
    - The use of purchasing cards that would allow the Board to restrict the types of purchases that can be made on the card based on industry codes. Casinos, specialty retail outlets, and food and beverage establishments are examples of these restrictions. The amount spent on a single purchase can also be restricted through the use of a purchasing card.
    - Reimburse employees personal credit card charges when the use is necessary. Procedures and supporting documentation requirements could be developed to facilitate this type of reimbursement.
  5. A review of budget to actual expenditures should be performed regularly to monitor costs in each account. If expenditures occur at an unexpected rate, additional detail should be requested to ensure that incurred expenditures are reasonable and necessary. This detail could include a check register that lists the payee and dollar amount of each expenditure. A review of this information could lead to additional questions that would strengthen internal controls.
  6. The Board meeting minutes should document the exact nature of the financial reviews conducted by the Board. Any conclusions or issues that result from these reviews should also be documented.
  7. The Board should ensure that closed sessions are entered into in accordance with Kentucky law. Any action taken as a result of discussions during a closed session must be taken in an open session following the closed session, and be documented in the Board meeting minutes.
  8. Expenses classified as gifts or entertainment should be documented to include the name and title of the person(s) involved and a description of why the expense was needed and how it relates to business operations.
  9. Specific marketing goals should be developed to monitor the success of any business promotions approved by the Board. Marketing expenditures incurred should be coded to that goal so that Board members will know the expenses involved in a specific marketing promotion.
  10. To facilitate the orientation process and serve as a useful reference tool, the Board should compile an orientation manual for new and returning Board members to ensure an understanding of their purpose and responsibilities. The manual should provide members with an understanding of the Board's structure, operations, and the responsibilities of each member and committee. An explanation of the budget and accounting structure, as well as revenue and investment information should also be included.

11. A policy related to employee reimbursement practices should be developed to ensure that any expenses that should be reimbursed by an employee are monitored. This policy should include the timeframe allowed for making the reimbursement and the alternative actions that will be taken if reimbursement is not made.
12. Reimbursements requested by executive management for business expenses should be reviewed by the Board to ensure supporting documentation is provided. This documentation should be retained to ensure that duplicate payments are not made to the employee.
13. The Board should ensure that its organizational structure maintains a flexibility that allows for multiple sources of information. Instead of always hearing activity reports from the same individuals, request reports from different positions to obtain a broader input of information. Personnel actions and accounts payable issues are areas where different perspectives may achieve a more accurate understanding of the business' actual operations.
14. The Board should establish methods that allow for concerns to be brought to their attention, including anonymous concerns. Employees, business associates, customers, or the general public may have significant, beneficial information but they are uncomfortable in reporting directly to the Board. A toll-free complaint number or an advertised email and postal address for feedback would allow the transmission of this information. In addition, the Board's policy should include a reference to Kentucky law notifying employees of their rights to protection against retaliation for reporting violations to certain authorities. A whistleblower policy should be adopted and distributed to employees. The policy should include reporting procedures and management's responsibility to address issues reported.
15. An internal audit function could be used to ensure that Board concerns are independently investigated. The individual designated to perform internal audits should be given the authority to investigate and examine any area designated by the Board and the responsibility to report the audits findings directly to the Board.
16. A Board audit committee should appoint and compensate the audit firm. This committee should consider the rotation of the lead audit partner and the audit partner reviewing the audit, as required by the Sarbanes Oxley Act (SOX) for companies with publicly traded stock. The Board should also consider whether rotating audit firms would be beneficial given the facts and circumstance of the organization. Ideally, the Board audit committee should be comprised of at least one member who is a financial expert as defined in Section 407 of SOX. In addition, reviews of internal controls should be conducted to ensure that controls are functioning as designed or needed. The review of internal controls could be conducted by an internal auditor, Board designee, or included in the engagement of an auditing firm. Any concerns noted by the Board should be disclosed to the auditor and included in the audit scope for review.
17. The personal use of business equipment should be addressed within Board policy to determine when appropriate. The policy should require that any missing equipment be reported directly to the Board.

18. To avoid lost or stolen financial information, financial records should be scanned so that electronic images will be retained. The Board should establish a policy detailing the process to report lost or missing financial information or records.
19. The Board should define and document all employee benefits in a fair and equitable manner. Benefits received that result in taxable income should be properly accounted for and accrued to each applicable employee. Employee benefits should also be reviewed to ensure that they are not personal in nature. Membership fees to organizations or associations should provide a reasonable business benefit. In addition, the practice of providing a vehicle should be reviewed and monthly vehicle allowances considered.
20. The Board should adopt policies to ensure all forms of employee leave are adequately approved and accounted for.
21. The Board should examine sick and vacation leave policies and determine whether leave payouts are made to employees. The practice of paying employees for any unused sick leave or vacation hours could result in significant expenditures that should be reviewed.
22. The Board should facilitate an independent assessment of salary ranges for similar positions across the industry.
23. The Board should ensure a well-defined employee evaluation system is implemented within the organization to consistently assess employee performance. The results of the employee's evaluation should be used for employee advancement or salary adjustments.
24. Salary increases and bonus payments approved during a specific period should be reviewed by the Board to ensure reasonableness. This review should be documented in the Board meeting minutes.
25. The Board should adopt a financial disclosure policy for Board members and executive management. A policy should also be developed requiring Board members and executive management to disclose any conflicts of interests. The disclosure form should be completed by a specified date and returned to the appropriate committee of the Board.
26. The Board should adopt a code related to business conduct, integrity, and ethics. The employees should sign a form stating that they have received and understand the Ethics Code. The code should include statements regarding moral and ethical standards, confidentiality, conflicts of interest, nepotism, gifts, honoraria, and assistance with applicable audits and investigations. The Ethics Code should include a reporting policy related to any violations.

27. An information system policy should be developed that explicitly defines a user's responsibilities as they relate to information system resources and applications. These policies should cover, at a minimum:
- Securing of user id and password;
  - Protection against computer virus or mal-ware infection;
  - Legal notice at logon indicating system is to be used for authorized purposes only;
  - Securing unattended workstations; and,
  - Securing portable devices, such as laptops, Blackberries, cell phones, etc.
28. A formal policy should be developed that identifies what equipment is a fixed asset and should be included as inventory. Once this designation has been made, the existing inventory listing should include the following identifying information related to each piece of equipment:
- Description of equipment;
  - Vendor name;
  - Model number;
  - Serial number;
  - Acquisition date; and,
  - Acquisition cost.

Once the inventory listing has been validated, any acquisitions and dispositions of computer equipment that fall within the fixed asset policy should cause an appropriate update to the inventory listing.